

KETUA PENGARAH HASIL DALAM NEGERI

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v.

PRIMARY PROPERTIES SDN BHD

HIGH COURT SABAH & SARAWAK, KUCHING
RHODZARIAH BUJANG JC

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[TAX APPEAL NO: 14-4-2008-I]

16 FEBRUARY 2009

REVENUE LAW: *Income tax - Appeal - Special Commissioners - Assessments - Cost of construction logging road and workers' camp for timber extraction business - Whether capital expenditures - Whether findings of SCIT reasonable and in accord with the law - Income Tax Act 1967, s. 33, 39, para 8 sch 3*

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REVENUE LAW: *Income tax - Appeal - Special Commissioners - Assessments - Cost of construction logging road and workers' camp for timber extraction business - Forest allowance - Whether given for expenses expended by concession holder or timber licensee in extraction of timber - Whether taxpayer contractually acquired rights and liabilities of licensee - Whether taxpayer entitled to claim forest allowance for expenses - Income Tax Act 1967, s. 33, 39, para 8 sch 3*

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Primary Properties Sdn Bhd ('the taxpayer'), a logging contractor, entered into an agreement with the main contractor, Liangti Sdn Bhd to fell and extract timber in a forest area held under timber license No T/3180. In order to extract timber from the forested area covered by the said license, the taxpayer had to construct roads (for their heavy machineries to go into the area) and build camps for their workers to stay. It was the taxpayer's argument that these costs of construction were revenue expenditure allowed as tax deduction under s. 33 read with s. 39 of the Income Tax Act 1967 ('the Act.'). The Special Commissioners of Income Tax ('SCIT') decided against the taxpayer and held that the temporary road construction cost of RM412,000 and workers' camp of RM69,869 for the year of assessment 1992 was capital expenditures which were not tax deductible under s. 33(1) of the Act and the loss adjusted in the sum of RM72,551 brought forward for the year of assessment 1991 was rightly made under the law. However, the SCIT held that cost of construction of the logging road and worker's camp were forest expenditure for which

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A the taxpayer was entitled to claim forest allowance under para. 8 of sch. 3 of the Act. Both the taxpayer and the Director General of Inland Revenue ('DGIR') were dissatisfied with the said decision and hence these appeals.

B **Held (dismissing DGIR and taxpayer's appeal):**

C (1) Construction of roads and workers' camp were pre-requisites to any timber extraction business. Considering the nature of these expenses, being a once and for all expenditures essential to the start of an operation in the timber extraction business for without the roads and the camp, the logging business would not even be viable, this court agreed with the finding made by the SCIT that they were capital expenditures. Paragraph 8(1)(a) and (b) of sch. 3 to the Act clearly provides that road construction for the extraction of timber and building provided for living accommodation of a person employed in connection with the extraction are capital expenditures. There was no justification, therefore, to disturb the finding of the SCIT on this score, it being reasonable and in accord with the law. (paras 12 & 13)

E (2) The purpose of para. 8(2) of sch. 3 of the Act is to give forest allowances for the expenses expended by the concession holder or timber licensee in the extraction of timber. The SCIT had correctly stated the timber industry practice of contracting out the work to another person. To strictly construe para. 8(2) to just concession holders and timber licensees would be to deny those who have been assigned the rights and liabilities under the license, such as the taxpayer, their legitimate expenses which they have expended to build roads and camps just like the concession holders and licensees would have done if they did the job themselves. Such a denial would lead to injustice, a grave one at that to contractors or sub-contractors like the taxpayer. Therefore, having contractually acquired the rights and liabilities of the licensee, the taxpayer was entitled to claim forest allowance for their expenses in constructing the roads and the workers' camp. (paras 18 & 19)

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Case(s) referred to:

- Atherton v. British Insulated Helsby Cables Ltd* 10 TC 155 (**fol**) A
Binastra Holdings Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri [2003] 5 CLJ 221 HC (**refd**)
Coltness Iron Co v Black (Surveyor Of Taxes) TC 287 (**fol**)
DGIR v. Teo Tuan Kwee [1998] MSTC 3648 (**refd**) B
Griffiths v. JP Harrison (Watford) Ltd [1962] 1 All ER 909 (**refd**)
Lower Perak Co-operative Housing Society Bhd v. KPDHN [1994] 2 MLJ 713 (**fol**)
Marshall (Inspector Of Taxes) v. Kern [1933] STC 360 (**refd**)
Ounsworth v. Vickers, Ltd [1915] 3 KB 267 (**fol**)
Vallambrosa Rubber Co Ltd v. Farmer 5 TC 529 (**fol**) C

Legislation referred to:

Income Tax Act 1967, ss. 33(1), 39

For the appellant/respondent - Nor Hisham (Nor Salwani with him)

For the respondent/appellant - KC Wong; M/s KC Wong & Assoc D

Reported by Suhainah Wahiduddin

JUDGMENT

Rhodzariah Bujang JC:

The Appeal

[1] This appeal concerned the decision made by the Special Commissioners of Income Tax ('SCIT') who decided, against Primary Properties Sdn Bhd ('the taxpayer') that the cost of constructing logging road and worker's camp were capital expenditures, non deductible under s. 33(1) of the Income Tax Act 1967 ('the Act') and against the Director-General of Inland Revenue ('the DGIR') that the taxpayer was entitled to claim forest allowances on the said expenditures under para 8 of Schedule 3 of the Act. F G

[2] Both the taxpayer and the DGIR were dissatisfied with the said decision and hence these appeals before me. H

The Parties

[3] The DGIR needs no introduction. The taxpayer, on the other hand, requires some introduction as their background plays a crucial role in determining the appeal they filed against the DGIR. I

- A [4] The taxpayer is a logging contractor, who had entered into an agreement with the main contractor, Liangti Sdn Bhd to fell and extract timber in a forest area held under timber license No. T/3180. The main contractor's right over the licensed area came from an agreement they had with the license holder of that timber
- B license, Sarawak Timber Industry Development Corporation (STIDC). Therefore, in relation to the timber license No. T/3180, the taxpayer was in fact a sub-contractor.

The Activities

- C [5] In order to extract timber from the forested area covered by the said license, the taxpayer had to construct roads (for their heavy machineries to go into the area) and build camps for their workers to stay. For the year of assessment 1991 the road construction cost the taxpayer RM308,687 which the DGIR
- D allowed as deductions for that year.

- E [6] However their claim to have the cost of more road construction in the sum of RM487,500 and worker's camp in the sum of RM69,869 for the year of assessment 1992 were disallowed. Similarly with the same cost (but for a different figure) for the year of assessment 1993. Subsequently, however, and against their earlier decision the DGIR decided to disallow tax deduction for the road construction cost of RM308,687 previously allowed for the year of assessment 1991, thus reducing the
- F adjusted loss for the year of assessment 1991 from RM382,788 to RM72,551 and the taxpayer was accordingly asked to pay additional tax of RM188,130.94.

- G [7] The taxpayer appealed against these disallowances to the SCIT.

The SCIT's Decision

- H [8] The SCIT's decision was to hold that the temporary road construction cost of RM412,000 and worker's camp of RM69,869 for the year of assessment 1992 were capital expenditures which were not tax deductible under s. 33(1) of the Act and the loss adjusted in the sum of RM72,551 brought forward for the year of assessment 1991 was rightly made under the law.

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[9] However, the SCIT held that cost of construction of the logging road and worker's camp were forest expenditure for which the taxpayer was entitled to claim forest allowance under para 8 of Schedule 3 of the Act.

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[10] The DGIR appealed against this latter finding and the taxpayer cross-appealed against the former finding of the SCIT.

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Whether Cost Of Road Construction And Worker's Camp Are Capital Expenditure

[11] It cannot be denied that the construction of roads and worker's camp are pre-requisites to any timber extraction business. Obviously, that business would be conducted in a forested area for which there would be no or limited access and the area would be far from human habitation. So the construction of roads and worker's camp are *sine qua non* in the timber extraction business.

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[12] The taxpayer argued that these costs of construction were revenue expenditure allowed as tax deduction under s. 33 read with s. 39 of the Act. Considering the nature of these expenses, being a once and for all expenditure essential to the start of an operation in the timber extraction business for without the roads and the camp, the logging business would not even be viable, I agree with the finding made by the SCIT that they were capital expenditures. In supporting their finding I was guided by firstly, the provisions of the Act itself, ie, para 8(1)(a) and (b) of Schedule 3 to the Act which clearly provides that road construction for the extraction of timber and building provided for living accommodation of a person employed in connection with the extraction are capital expenditures and secondly, the case authorities submitted by counsel for both sides. These cases are: (i) *Vallambrosa Rubber Co Ltd v. Farmer* 5 TC 529 (from where I borrowed the phrase 'once and for all'), (ii) *Coltness Iron Co v. Black (Surveyor Of Taxes)* TC 287 where the expense of sinking pits in a coal mine was held to be capital expenditure, (iii) *Ounsworth v. Vickers, Ltd* [1915] 3 KB 267 where the expense of deepening a channel by a shipbuilding firm was also held as capital expenditure and lastly, (iv) *Atherton v. British Insulated Helsby Cables Ltd* 10 TC 155 which further decided that once and for all expenses made with a view into bringing into existence an asset or an advantage for the enduring trade were capital expenditure. Obviously, an analogy can be drawn between the road and

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A worker's camp with the sinking pits and the deepening channels, which were not only advantages but, as I said earlier, downright essential to the timber extraction business.

B [13] I see no justification, therefore, to disturb the finding of the SCIT on this score, it being reasonable and in accord with the law. (See *Griffiths v. J.P. Harrison (Watford) Ltd* [1962] 1 All ER 909 and *Lower Perak Co-operative Housing Society Bhd v. KPDHN* [1994] 2 MLJ 713.

C **The Forest Allowance**

D [14] Moving now to the DGIR's appeal on the SCIT's finding that the above expenses were forest allowance, I bear in mind the advice given by Edgar Joseph Jr SCJ in *Lower Perak Co-Operative's* case (*supra*) when His Lordship defined my role in this appeal. It is, said His Lordship '... to examine the special commissioners' determination having regard to the law. If there is anything *ex facie* which is bad law, or where no person could have come to that determination, or where it is not supported by the evidence or is inconsistent with and contradictory of it, the court must intervene'.

E [15] Paragraph 8(2) of Schedule 3 to the Act provides that in respect of forest expenditure the person who can claim it as allowance would be the one who '... has a concession or a license to extract timber therefrom ...' It is obvious that the taxpayer was
F neither a concession holder nor a licensee (that would be STIDC). Nevertheless the SCIT held, applying the purposive approach in interpreting the said sub-para 2, that the taxpayer was the '... one who runs the business and incurred the expenses. If the allowance is only given to licensee, no one will get the
G benefit of this provision as in logging business, it is common that the licensee will not run the business but the license is assigned to contractor to extract timber'. The SCIT further referred to the case of *DGIR v. Teo Tuan Kwee* [1998] MSTC 3648 where the word 'owner' includes both legal owner as well as 'beneficial
H owner' and found that the taxpayer was a beneficial owner of the license and therefore entitled to the forest allowance.

I [16] Whilst I do agree with the SCIT's conclusion that the taxpayer should derive benefit from para 8(2), I disagree that *Teo Tuan Kwee's* case can be used to support that conclusion. That is because that case concerned specifically a provision of the law ie, para 13 of Schedule 3 to the Act where the word 'owner' was

used. Thus it was open for interpretation whether ‘owner’ included ‘beneficial owner’ but one cannot use that ratio to say that beneficial ownership is permitted by the Act and covers this situation where the wordings are different and is definitely more precise ie, a person who has a ‘concession’ or a ‘license’ to extract timber.

[17] In my view, the pertinent question to ask is whether that ‘person’ described in para 8(2) includes a person who extracts timber for or on behalf of the concession holder or the licensee.

[18] In this regard, I would agree with the SCIT that a purposive interpretation of para 8(2) be made. I take comfort from deciding so from the decision of Peter Gibson J in *Marshall (Inspector Of Taxes) v. Kern* [1933] STC 360 which was quoted with approval in *Binastra Holdings Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri* [2003] 5 CLJ 221 when His Lordship said:

For my part, I take the correct approach in construing a deeming provision to be to give the words used their ordinary and natural meaning, consistent so far as possible with the policy of the Act and the purposes of the provisions so far as construction would lead to injustice or absurdity, **the application of the statutory fiction should be limited to the extent needed to avoid such injustice or absurdity**, unless such application would clearly be within the purpose of that fiction. (emphasis added).

The purpose of para 8(2), in my view is to give forest allowance for the expenses expended by the concession holder or timber licensee in the extraction of timber. The SCIT has correctly stated the timber industry practice of contracting out the work to another person. To strictly construe para 8(2) to just concession holders and timber licensees would be to deny those who have been assigned the rights and liabilities under the license, such as the taxpayer, their legitimate expenses which they have expended to build roads and camps just like the concession holders and licensees would have done if they did the job themselves. Such a denial would lead, given the industry practice alluded to earlier, to injustice, a grave one at that to contractors or sub-contractors like the taxpayer. There is further justification for this view because as stated earlier these costs were once and for all expenses for in respect of this particular timber license after the timber was extracted, that license would be a spent force. In other words,

- A the fear that another contractor, Liangti Sdn Bhd or STIDC claiming forest allowance for the same expenses for the same area where the taxpayer had extracted timber would be virtually nil. The DGIR cannot and should not be allowed to dispute that these were once and for all expenses because in the first place,
- B that was one of the criteria they adopted in their submission when arguing that these were capital expenditures.

- [19] Therefore, having contractually acquired the rights and liabilities of the licensee, the taxpayer was entitled to claim forest allowance for their expenses in constructing the roads and the workers' camp.
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[20] Accordingly, I dismiss both the DGIR and the taxpayer's appeal with each party to bear their own costs.

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